

ONTARIO INVESTMENT AND WORKER
OWNERSHIP PROGRAM : A PROPOSAL
FOR DISCUSSION

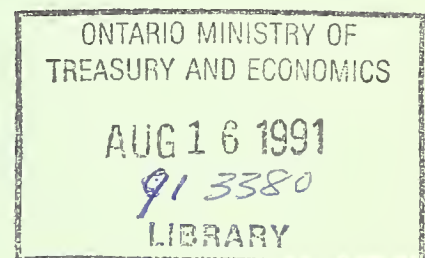


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**ONTARIO INVESTMENT
AND
WORKER OWNERSHIP PROGRAM:
A PROPOSAL FOR DISCUSSION**



Ministry of Treasury and Economics
Province of Ontario
August 15, 1991

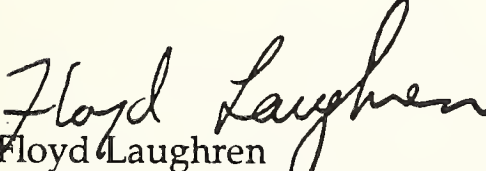
PREFACE

The Ontario economy is undergoing fundamental restructuring as a result of changing markets and growing international competition. To meet these new economic challenges, businesses need better access to sources of capital and employees need to be full partners in both the decision-making process and the opportunities that are being created.

On June 20, 1991, I announced in the Legislature the Government's intention to introduce a program to encourage individuals to invest in Ontario businesses. This was followed by my announcement on July 31, 1991, which elaborated on some of the key features of the proposed program and outlined the time frame for consultations.

I am pleased to release for consultation a proposal to establish the *Ontario Investment and Worker Ownership Program*. The proposed program will be an important step in achieving the Government's twin objectives of facilitating investment in restructuring and growth and encouraging worker ownership and participation in the restructuring process. To ensure that this program is designed to best meet these objectives, the Government is seeking the views of interested individuals and organizations.

I am confident that this program will encourage the formation of the new partnerships required to achieve sustainable prosperity. After all, it is only by working together that business, labour, government and other members of the community will find the creative solutions that work best for Ontario.


Floyd Laughren
Treasurer of Ontario



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- no more than 500 employees; and
- at least 50 per cent of wages and salaries paid to workers at permanent establishments in Ontario.

Investments in any one business will be limited to the lesser of ten per cent or \$10 million of the Fund's assets. A Labour-Sponsored Investment Fund will also be restricted to holding minority positions in the businesses in which it invests.

How Does a Labour-Sponsored Investment Fund Raise Capital?

A registered Fund will be authorized to issue several classes of shares:

- Class A shares will be issued only to individual investors who are Ontario residents. These shares will have full voting and dividend rights.
- Class B shares will be issued only to the sponsoring labour organization. These shares will have voting rights but will not be entitled to dividends.
- Additional classes of shares may be issued as desired by the Fund's Board of Directors. These shares provide an opportunity for a Fund to attract additional Ontario-based investors, such as pension funds.

What are the Tax Credits for Individual Investors?

Ontario residents who purchase Class A shares of a registered Labour-Sponsored Investment Fund will be eligible for Ontario tax credits of 20 per cent on the first \$3,500 invested in any year. Purchasers of other classes of shares will not be eligible for tax credits.

If the federal government accepts the Ontario program, the individual will also be eligible for a matching federal credit of 20 per cent on a maximum annual investment of \$3,500. The maximum combined tax credit would be 40 per cent on investments of up to \$3,500.

What Conditions are Placed on Individual Investors?

Except in certain circumstances, individual investors will forfeit their tax credits if their shares are redeemed within five years of purchase. Exceptions will include death, permanent disability, long-term illness and retirement.

B. "Employee-Ownership" LSVCCs

Who Can Set Up an "Employee-Ownership" LSVCC?

An "employee-ownership" LSVCC can be established by any employee group that wishes to purchase a majority interest in its employer's business. Before an "employee-ownership" LSVCC can be established, all employees must be given an opportunity to vote on the

initiative. A majority of those employees who vote must support the establishment of the "employee-ownership" LSVCC.

The employee group would submit for approval an application to a Tripartite Review Board consisting of labour, business and government representatives. The application would include information on the employee group's business plan and human resources plan.

What Conditions are Placed on Investments by an "Employee-Ownership" LSVCC?

A registered LSVCC will be allowed to purchase shares of, or a partnership interest in, a single "eligible business".

"Eligible businesses" will be required to have at least 25 per cent of their wages and salaries paid to employees at permanent establishments in Ontario.

The LSVCC must acquire majority ownership of the eligible business.

How Does the "Employee-Ownership" LSVCC Raise Capital?

A registered "employee-ownership" LSVCC will be authorized to issue shares only to employees of the eligible business. The employees' shares will have full voting and dividend rights.

At the time of registration, the total authorized capitalization for the LSVCC will be approved. The LSVCC will be prohibited from raising additional capital without prior approval.

What are the Tax Credits for Individual Investors?

Employees who are Ontario residents will be eligible for an Ontario tax credit of 20 per cent on the first \$3,500 of annual investments and a credit of up to 30 per cent on the next \$11,500. The Ontario tax credit will be available on a maximum annual investment of \$15,000.

If the federal government accepts the Ontario program, the individual will also be eligible for federal LSVCC tax credits.

A cumulative limit will also be applied to the total tax credit available to each employee in respect of investments in an "employee-ownership" LSVCC. The credit will be provided only on the first \$150,000 of the employee's investment in an "employee-ownership" LSVCC.

What Conditions are Placed on Individual Investors?

Except in certain circumstances, individual investors will forfeit their tax credits if their shares are redeemed within five years of purchase. Exceptions will include death, permanent disability, long-term illness, retirement and involuntary termination of employment.

CHAPTER 1: BACKGROUND

1.1 Restructuring and Sustainable Prosperity

The Ontario economy is undergoing profound and far-reaching structural change. This is being driven by several factors including: technological innovation; a shift to knowledge-based production; a decline in the export price of resource products relative to manufacturing and service products; a shift in employment from the manufacturing sector to the service sector; and the growing integration of the world economy.

To address the challenges and opportunities presented by this period of change, the Ontario Government is pursuing an economic strategy of sustainable prosperity. The objectives of this strategy are a prosperous society which provides high levels of employment in well-paying, high-quality jobs; a society which respects the environment; shares the costs and benefits of change equitably; and provides services to promote the health, education and social well-being of its citizens.

The Ontario Government believes that a concerted and co-operative approach on the part of business, labour, government and other members of the community is required to achieve the goal of sustainable prosperity. The 1991 Budget indicated the Government's commitment to creating the conditions necessary to encourage these partnerships.

The Budget also proposed that government enlist the participation and advice of business, labour and all other interested sectors in designing and implementing initiatives to:

- channel capital to finance industrial restructuring and promote regional development; and
- foster the development of practices which will provide workers with the security and influence necessary to enable them to accept and initiate change.

The proposed program is an integral part of the Government's commitment to initiating the co-operative responses needed to achieve sustainable prosperity.

1.2 The Labour-Sponsored Venture Capital Corporation Framework

In Canada, the Labour-Sponsored Venture Capital Corporation (LSVCC) framework has been developed to deal with the twin policy objectives of financing industrial restructuring and growth and encouraging greater worker participation in the economy.

Under this framework, tax credits are available to:

- individuals who invest in a labour-sponsored investment fund; and
- employees who take a significant, collective ownership position in their employer's business.

Labour-Sponsored Investment Funds

Labour-sponsored investment funds provide businesses with a new source of capital for restructuring. They also provide a mechanism for labour to act collectively as a partner in financing industrial restructuring and growth.

- A labour-sponsored fund is more equitable than many other investment incentives because its incentives are accessible by, and attractive to, workers in all income brackets.
- Establishing a labour-sponsored fund which meets the requirements of federal LSVCC legislation allows investors to take advantage of combined federal-provincial tax credits.
- A tax-assisted labour-sponsored investment fund is a desirable vehicle for facilitating investments in provincial restructuring and growth because it encourages partnership-building in meeting economic challenges.
- Through administrative features such as payroll deductions and workplace sales representatives, labour-sponsored funds can increase the pool of savings available for investment in the province.¹
- Research suggests that developing partnerships, through vehicles such as provincial labour-sponsored investment funds, is an important step in maximizing access to capital for economic growth, particularly in less developed regions.²

Employee Ownership

Employee ownership provides individuals with opportunities for substantive participation in their workplace, and can contribute to the stability of local economies.

- Research on employee ownership and productivity consistently suggests that, when combined with mechanisms for employee participation such as labour-management problem-solving groups, employee ownership leads to heightened corporate performance.³

¹ Ethan Phillips and Associates, *Policies in Support of Job-Saving Restructuring: Volume 2, A Review of Policy Options in Support of Worker Ownership and Labour-Sponsored Investment Funds*. A Study Prepared for the Policy Branch of the Ministry of Labour, May 1990, p.40.

² Edward T. Jackson and Jon Peirce, *Mobilizing Capital for Regional Development*. Economic Council of Canada Local Development Paper No.21, April 1990, p.76.

³ Michael A. Conte and Jan Svejnar, "The Performance Effects of Employee Ownership Plans", *Paying for Productivity: A Look at the Evidence*, ed. Alan S. Blinder, 1990, pp.143-181.
David I. Levine and Laura D'Andrea Tyson, "Participation, Productivity and the Firm's Environment", *ibid.* pp.183-243.

- In situations where there is no purchaser for a retiring owner's share of a viable enterprise, or where a foreign parent is divesting a branch of its business, employee ownership can provide an alternative to plant closures and job losses, and can contribute to regional economic stability.
- Employee-owned and operated businesses add stability to the local economy because the profits are more likely to stay in the community.

CHAPTER 2: LSVCCS IN OTHER CANADIAN JURISDICTIONS

2.1 Quebec

The Quebec Solidarity Fund (QSF) was the first labour-sponsored investment fund developed in Canada. Established in 1983, the Fund was the outcome of an agreement between the Quebec Federation of Labour and the provincial government.

The government created the Fund to address a perceived gap in the equity financing needs of small and medium-sized firms in Quebec and to allow the labour movement to become a more active participant in the economic development process. For its part, the Quebec Federation of Labour sought to help the province out of a period of economic difficulty and move toward full employment. To get the Fund started, the Quebec and federal governments contributed seed capital of \$10 million and \$11 million respectively.

The QSF is controlled by the Quebec Federation of Labour, and is based on voluntary investments by individuals. Originally, the Quebec government provided QSF investors with a 35 per cent tax credit. It was reduced to 20 per cent in 1985 when the federal government introduced a matching 20 per cent tax credit. The tax credits are available on a maximum annual investment of \$3,500. In addition, QSF shares are eligible investments for registered retirement savings plan (RRSP) purposes.

Investments in the QSF are locked in until the investor retires or dies. Some exceptions are permitted, including: attaining age 60; becoming disabled; returning to school; starting a business; and exhausting unemployment insurance benefits.

The QSF is required to hold at least 60 per cent of the previous year's average net assets in unsecured investments (ie. shares, loans and advances) in eligible Quebec companies. The maximum size limit for eligible companies was recently set at \$50 million in assets or \$20 million in net worth.

The QSF is normally restricted to investing a maximum of five per cent of its total assets in any single undertaking. However, up to ten per cent of the Fund's assets can be invested in a single business if the business has more than \$50 million in assets or \$20 million in net worth, and the Fund is acquiring no more than 30 per cent of the entity's shares. As a rule, the QSF takes a minority position of 20 to 30 per cent in the companies in which it invests.

The Quebec Federation of Labour estimates that the Fund has helped support 18,000 jobs.

2.2 Federal Government

In 1985, in response to the QSF initiative, the federal government introduced a 20 per cent tax credit for individuals investing in LSVCCs established at the provincial level. Under this program, the federal tax credit is contingent upon the province providing a tax credit equal to at least 20 per cent of the cost of the shares. The maximum combined federal and provincial tax credit is 40 per cent of the cost of the shares.

In 1990, the federal government introduced legislation to extend its 20 per cent tax credit to individuals investing in shares of LSVCCs set up at the national level by a national central labour body comprised of at least two trade unions. The 20 per cent federal tax credit for investors in national LSVCCs is not contingent on the provinces offering a matching 20 per cent tax credit. To date, the Canadian Federation of Labour's Working Ventures Canadian Fund is the only LSVCC to be registered under this legislation.

The federal LSVCC credit is available on annual investments of up to \$3,500 (ie. the maximum credit is \$700). Shares in federal LSVCCs and in provincial LSVCCs which are accepted by the federal government are eligible investments for RRSP purposes. In addition, investors receive preferential tax treatment when a capital gain is realized on the sale of LSVCC shares. The tax credits are not included in calculating the original cost of the shares. As a result, the individual's capital gain only includes the change in the value of the share over the original purchase price. Under most circumstances, an individual's investment can only be redeemed after eight years.

During its first five years, a federally registered LSVCC must invest 80 per cent of capital received from shareholders in a combination of reserves and eligible investments. Thereafter, at least 60 per cent must be invested in eligible investments. Eligible investments are small and medium-sized Canadian businesses with a maximum of \$35 million in assets and 500 employees.

2.3 Saskatchewan

In 1989, Saskatchewan introduced legislation to permit the establishment of two types of provincial LSVCCs.

- "Type A" LSVCCs are "mutual-fund" LSVCCs, closely resembling the federal and Quebec models outlined above. A "Type A" LSVCC can be established by recognized "labour associations", including a trade union, a corporation formed by employees of the same company or an investment co-operative. The LSVCC can sell equity shares to anyone who is resident and employed in Saskatchewan. The proceeds must be invested in small and medium-sized Saskatchewan businesses with no more than 300 employees.
- "Type B" LSVCCs are "employee-ownership" LSVCCs which can only sell shares to employees of a given company. The proceeds are invested solely in the employer firm. The LSVCC may purchase up to 100 per cent of the shares of the employer firm.

Both types of LSVCCs are restricted to raising a maximum of \$5 million in equity capital. They are also required to hold at least 60 per cent of their equity capital in the shares of eligible businesses, with the remainder placed primarily in either debt or equity of eligible businesses. "Type A" LSVCCs are given 30 months to meet this requirement; "Type B" LSVCCs have six months.

Investors in "Type A" LSVCCs, "Type B" LSVCCs and federal LSVCCs are eligible for a 20 per cent Saskatchewan and a 20 per cent federal tax credit on annual investments of up to \$3,500. The maximum combined annual credit per investor is \$1,400. Under most circumstances, the investor's minimum holding period is five years.

2.4 British Columbia

In 1989, British Columbia introduced legislation to provide a 20 per cent tax credit to workers investing in a provincial LSVCC. The British Columbia legislation refers to these as Employee Venture Capital Corporations (EVCCs).

An EVCC can be established by a labour organization or other group of people with a "work-related affiliation". An EVCC can only invest in firms in specific sectors that have less than \$35 million in assets and pay at least 50 per cent of their wages to British Columbia employees.

- In general, EVCCs are restricted to minority positions in investee corporations. Total EVCC investment in any one eligible business is restricted to no more than \$5 million in any two-year period.
- In special cases such as financial difficulty and major restructuring of ownership, an EVCC may be allowed to take a majority position in a single corporation provided that the corporation meets all of the criteria for an eligible investment.

Investors in both types of EVCCs, the general and the special case versions, are eligible for the federal and provincial 20 per cent tax credits. Investors receive the provincial credit on annual investments of up to \$10,000, while the federal credit applies only to the first \$3,500 invested. Investors are also subject to a lifetime provincial investment limit of \$50,000.

A cap is also placed on the total amount of provincial tax assistance. For 1991 and subsequent years, the total amount of credits available during a year for all EVCCs and provincial Employee Share Ownership Plans is restricted to \$13 million per year.

The amount of capital that an individual EVCC can raise is restricted to \$5 million if the EVCC is a private corporation and to \$20 million if it is public. An EVCC must have 80 per cent of any capital raised during the fiscal year invested in eligible businesses by the end of its following fiscal year.

The provincial government assists employee groups and companies with less than 150 employees to obtain professional advice by paying half the professional fees associated with setting up an EVCC, to a maximum of \$10,000 per employee group and \$10,000 per eligible employer.

2.5 Manitoba

In July 1991, the Manitoba government introduced legislation to establish a labour investment fund sponsored by the Manitoba Federation of Labour.

The fund will be required to invest in "eligible investments". These will include shares, specified debt instruments or partnership interests in "qualified Manitoba business entities". Qualified business entities are businesses which operate in specified industries and which have less than \$50 million in assets and a majority of employees in Manitoba.

No more than ten per cent of the fund's investment assets can be invested in a single Manitoba business entity. After four years the fund will be required to hold at least 60 per cent of its investment assets in eligible investments.

The fund will be able to issue several classes of shares including a class for institutional investors. These shares will entitle institutional investors, such as pension funds, to representation on the fund's Board of Directors. Regardless of the size of their investments, institutional investors may only obtain minority Board representation.

Individuals investing in the fund will be entitled to a Manitoba tax credit of 20 per cent on annual investments of up to \$3,500. If the federal government accepts Manitoba's program, individual investors will also be eligible for a matching federal credit of 20 per cent, for a combined credit of 40 per cent.

Individual investors may request the fund to redeem their shares on or after retirement (if the investor is at least 60 years of age), the investor's 65th birthday or death, or the occurrence of financial hardship. To provide greater liquidity for individuals' investments, the Board of Directors may add a provision which would allow redemptions after a minimum holding period of seven years.

CHAPTER 3: DESCRIPTION OF THE ONTARIO PROPOSAL

3.1 Overview

The proposed Ontario Investment and Worker Ownership Program consists of two components.

The first component encourages individuals to invest in a diversified portfolio of small and medium-sized businesses through a Labour-Sponsored Investment Fund. This component is modelled after the "mutual fund" type LSVCC programs in existence at the federal level and in other provinces.

Labour organizations wishing to participate in the program will register a Labour-Sponsored Investment Fund with the Province. The Fund would be similar to a mutual fund in that individuals purchase shares of the Fund which in turn invests in a number of businesses. As an incentive for individuals to invest in a Labour-Sponsored Investment Fund, the Province will provide a tax credit of 20 per cent on share purchases of up to \$3,500 per year, for a maximum annual Ontario tax credit of \$700.

Ontario is seeking federal participation in the program. If the federal government matches the Ontario credit, workers will receive up to \$1,400 annually in federal and Ontario tax credits.

The second component of the program supports employee ownership. British Columbia and Saskatchewan have similar employee-ownership components in their LSVCC programs.

In a number of situations, such as plant closures or the retirement of an owner, the employees may wish to purchase the business. In these instances, the employees will have the option of establishing an "employee-ownership" LSVCC. Unlike the Labour-Sponsored Investment Fund described above, the "employee-ownership" LSVCC will be restricted to investing only in the employer's business.

To assist employees acquire a majority interest in their employer's business, Ontario will provide tax credits to employees investing in an "employee-ownership" LSVCC. The allowable annual contribution limit will be higher than that available for investments in Labour-Sponsored Investment Funds.

Both the Labour-Sponsored Investment Funds and the "employee-ownership" LSVCCs will be restricted to investing in businesses operating in Ontario.

3.2 Program Administration

Separate administrative procedures will be put in place for Labour-Sponsored Investment Funds and "employee-ownership" LSVCCs.

Labour-Sponsored Investment Fund Administration

A provincial-level trade union organization interested in establishing a Labour-Sponsored Investment Fund will apply to the Ministry of Revenue for registration. The program's legislation will set out the information that must be submitted with the application.

The Ministry of Revenue will ensure that the application complies with the program's requirements and other relevant legislation. Upon approval of the application, the Fund will be registered.

The Ministry of Revenue will also monitor each Fund's ongoing activities to ensure compliance with the legislation. To facilitate this process, each Fund will be subject to annual reporting requirements as specified in the legislation.

"Employee-Ownership" LSVCC Administration

Employees interested in establishing an "employee-ownership" LSVCC will submit an application to the Ministry of Industry, Trade and Technology. The legislation for the program will list a number of information requirements, including business and human resources plans.

After the Ministry verifies that the employee group has submitted all the necessary information, the application will be forwarded to a Tripartite Review Board consisting of labour, business and government representatives. The Board will bring together the different perspectives and expertise required to ensure that the proposed employee buyout is commercially viable.

Once the Board has concluded its evaluation, the application will be forwarded to the Ministry of Revenue for processing. Provided that the other aspects of the application are consistent with the program's requirements, registration will be granted.

The Ministry of Revenue will provide the ongoing administration to ensure compliance with the legislation.

3.3 Labour-Sponsored Investment Funds

Registration of Labour-Sponsored Investment Funds

A provincial-level trade union organization must register the Labour-Sponsored Investment Fund under the accompanying legislation for the Fund's shareholders to be eligible for the proposed Ontario tax credit. A number of conditions will have to be satisfied in order to obtain registration as a Labour-Sponsored Investment Fund.

The key conditions for registration will include:

- The Fund must be newly incorporated under Ontario or federal law. This requirement ensures that the Fund does not "inherit" liabilities of existing businesses.
- The articles of incorporation must restrict the Fund's activities to those that are permitted under the legislation, and must stipulate that the Fund's activities will be controlled by a Board of Directors, the majority of whom will be appointed by the sponsoring labour organization.
- The Fund must file an "investment plan" that specifies, among other things:
 - the amount of equity capital to be raised under each class of shares issued by the Fund⁴;
 - the amount and nature of any debt that will be incurred by the Fund;
 - details of the Fund's investment policy, including any restrictions on the types of businesses in which it intends to invest;
 - any restrictions on share ownership in the Fund;
 - the terms and conditions for redemptions of shares by plan members; and
 - the estimated number of investors that are expected to participate in the Fund.

Investments by Labour-Sponsored Investment Funds

The purpose of the Labour-Sponsored Investment Fund component of the program is to provide capital to small and medium-sized Ontario businesses. As a result, the Funds will be restricted to making "eligible investments" in "eligible businesses".

Definition of Eligible Investments

Eligible investments of a Labour-Sponsored Investment Fund will include newly issued shares of, and new unsecured loans to, eligible businesses. The Labour-Sponsored Investment Fund will also have some flexibility to invest in replacement capital.

Since Labour-Sponsored Investment Funds are primarily intended to provide a source of new capital for small and medium-sized businesses, at least two-thirds of their eligible investments must be in newly issued debt or equity. A Labour-Sponsored Investment Fund

⁴ When the LSVCC reaches the capitalization limit contained in its original investment plan, the LSVCC can file appropriate information with the Ministry of Revenue indicating the additional amounts of equity capital that it intends to raise.

will be allowed to invest up to one-third of its assets in replacement capital where it is acting as an equity partner with one or more "employee-ownership" LSVCCs.

A Labour-Sponsored Investment Fund is restricted to investing in the new or replacement capital of eligible businesses, as defined below.

Definition of Eligible Businesses

To qualify as an eligible business, the entity⁵ together with any related businesses, must be an active business that, at the time the investment is made, has:

- no more than \$35 million in assets;
- no more than 500 employees; and
- at least 50 per cent of its wages and salaries paid to workers at permanent establishments in Ontario.

To qualify as an eligible business, the entity will also be required to have met these criteria for the previous two-year period, or for the length of time the business has been in existence, whichever is shorter.

Eligible businesses can be active in any industry in Ontario. The need for new capital exists in small to medium-sized businesses throughout the economy. Individual LSVCCs will be able to target their investments to particular industrial sectors if desired. Such information will form part of the investment plan filed prior to registration.

Restrictions on Investments

No more than the lesser of ten per cent or \$10 million of a Labour-Sponsored Investment Fund's assets can be invested in any one eligible business. This ensures that investment risk is minimized through diversification. The LSVCC will also be restricted to holding minority positions in the businesses in which it invests.

The Labour-Sponsored Investment Fund will be required to invest at least 40 per cent of its assets in eligible investments within 24 months of first issuing its shares to eligible investors. This increases to 70 per cent after 48 months of first issuing its shares. The LSVCC will then be required to maintain this investment level on an ongoing basis. These time periods recognize that the Labour-Sponsored Investment Fund will require some time between raising the capital from investors and investing the funds in eligible businesses.

Fund assets not invested in eligible investments must be held in secure liquid investments such as investment certificates or government securities. The Fund's annual expenses will be funded by the portion of its assets not invested in eligible investments. Details regarding the nature of these expenses will be included in the information filed with the application for registration.

⁵ As in the federal LSVCC legislation, eligible businesses will include taxable Canadian corporations, and Canadian partnerships, that carry on an active business.

Capitalization Limits

In order to encourage the growth of Labour-Sponsored Investment Funds, no restrictions are placed on the amount of capital that a Fund can raise.

Share Valuations

Labour-Sponsored Investment Funds will be required to have their shares valued semi-annually either by an independent valuator or through an approved formula. The Fund will update these valuations on a monthly basis to reflect significant changes in the assets of the Fund. Any share redemptions by the Fund will be based on these valuations.

Conditions for Maintaining Fund Status

As indicated above, a Labour-Sponsored Investment Fund will have to maintain the required level of investment in eligible businesses throughout its existence. Annual reporting requirements will be used to monitor the Fund's compliance with the legislation. This annual report, which will be in addition to any other applicable reporting requirements under Ontario law, will include such information as:

- the Fund's financial statements;
- a detailed breakdown of the Fund's investments, including information on the amounts and types of investment in each eligible business, the size of the eligible businesses and the industries in which they are active;
- amounts of new capital raised and a listing of new investors;
- details on share redemptions; and
- information on any changes to the Fund's articles of incorporation.

Penalty taxes will be imposed on any Fund that does not maintain the required minimum percentage of its assets in eligible investments. The registration of a Fund may also be revoked if it fails to comply with the legislation.

If the Fund's registration is revoked or the Fund ceases operations, it will be required to repay any tax credits claimed by individuals investing in shares issued within five years of the termination of its registration.

Eligible Investors

Definition of Eligible Investors

A Labour-Sponsored Investment Fund will have the flexibility to issue several classes of shares.

- Class A shares will be issued only to individuals resident in Ontario. These shares will have full voting and dividend rights and will entitle the investor to receive the tax credit. The shares will be subject to the redemption conditions discussed below.
- Class B shares will be issuable only to the sponsoring labour organization. These shares will have voting rights but not rights to dividends or to tax credits.
- Additional classes of shares with specified rights, excluding the right to receive tax credits, may be issued as desired by the Board of Directors. These shares will give the Labour-Sponsored Investment Fund the opportunity to attract additional Ontario-based investors, such as pension funds.

Tax Incentive

Individual investors will be eligible for an Ontario tax credit of 20 per cent on the first \$3,500 of annual investments in shares of a registered Labour-Sponsored Investment Fund. If the federal government accepts the Ontario program, the individual will also be eligible for the federal credit of 20 per cent on a maximum annual investment of \$3,500. The maximum annual combined tax credit would be \$1,400 on a \$3,500 investment.

The Ontario tax credit can be applied up to the amount of Ontario tax owing for the year and will not have any carry-forward provisions.

The Ontario program will recognize federally registered LSVCCs and will provide the 20 per cent Ontario tax credit for investments in these LSVCCs if the federal LSVCC conforms with the Ontario program requirements.

Restrictions on Investors

With the exceptions noted below, individual investors will forfeit their tax credits if their shares are redeemed within five years of purchase. Where an investor has shares redeemed within the five-year period, the Fund will be required to withhold from the proceeds otherwise payable to the individual an amount equal to the related tax credits⁶. The Fund will remit these recaptured tax credits to the Province. Sales or other transfers of the shares will not be permitted within the five-year holding period.

The five-year holding period reflects the program's intention to encourage long term investments. The holding period also addresses concerns regarding potential abuse of the program to obtain the benefits of the tax credits through "quick flips" of shares in the LSVCC.

Shares can be redeemed without recapture of the tax credits within the five-year holding period in limited circumstances: where the original purchaser dies, becomes permanently disabled or is unable to work because of long-term illness, or retires. Where the original purchaser retires, the shares must be outstanding for at least two years to avoid recapture of the tax credits.

⁶ The LSVCC will be required to redeem the shares unless such a redemption would not be permitted as a result of the solvency restrictions in the Ontario Business Corporations Act.

3.4 "Employee-Ownership" Labour-Sponsored Venture Capital Corporations

Registration of "Employee-Ownership" LSVCCs

An employee group wishing to establish an "employee-ownership" LSVCC will be required to submit an application which includes:

- an "investment plan" similar to that required for registering a Labour-Sponsored Investment Fund;
- a business plan which allows the Tripartite Review Board to evaluate the commercial viability of the plan;
- a human resources plan outlining the process through which the employees will participate fully in the ongoing management of the corporation and, where necessary, measures for training and adjustment of the workforce;
- a description of the procedures that will be put in place to preserve the employees' pension benefits;
- a plan outlining the procedures for distributing the LSVCC's shares to employees in a fair and equitable manner and complying with all applicable laws; and
- the collective agreement or other contract outlining whether participation in the plan is voluntary or mandatory.

There may be a need to assist employees in assessing the merits and feasibility of investing in their employer's business.

The requirement that the employees prepare a commercially viable business plan assists in focusing the program on companies with a solid future. The purpose of the human resources plan is to encourage the adoption of participatory workplace practices and to create an environment for improved productivity.

Investments by "Employee-Ownership" LSVCCs

Definition of Eligible Investments

An "employee-ownership" LSVCC will be allowed to invest in only one eligible business. This investment could be in shares of a taxable Canadian corporation or a partnership interest in a Canadian partnership.

Unlike a Labour-Sponsored Investment Fund, an "employee-ownership" LSVCC will be able to acquire existing shares or partnership interests.

Definition of Eligible Businesses

The eligible business can be either the entire existing operations of the business or only a portion of the operations. In either case, the eligible business will be required to have at least 25 per cent of its total wages and salaries attributable to permanent establishments in Ontario.

An eligible business includes a corporation or a partnership that had acquired, or planned to acquire, a branch or division of another entity as a going concern. The "employee-ownership" LSVCC will acquire shares in the new corporation, or an interest in the new partnership, established to conduct the eligible business.

The program proposes no restrictions on the size of the business or the industries in which "employee-ownership" LSVCCs can invest. This recognizes that employees in all sizes of companies and all industries can face situations in which the existing owners are seeking to sell the business (e.g. retirement of current owners or plant closures). All employees in these circumstances should have an equal opportunity to influence their future employment prospects through an ownership role.

The program is intended to address the restructuring needs of existing businesses. Financial and technical assistance for start-ups is currently provided through several Ontario programs, including the Labour-Sponsored Investment Fund component of this proposed program.

Employee Approval and Minimum Ownership Requirements

Before an "employee-ownership" LSVCC can be established, all eligible employees must be given an opportunity to vote on the initiative. At least half of those employees who vote must support the establishment of the "employee-ownership" LSVCC.

If the intended investment is a business that operates both within and outside Ontario, employees in locations outside Ontario must be eligible to vote. If the intended investment is only a portion of the operations, only the employees at that location will be entitled to vote. Where at least half of the employees in the eligible business that would be acquired are represented by a recognized labour organization(s), a majority vote of these bargaining-unit employees will be sufficient to establish the "employee-ownership" LSVCC.

Specific rules will be developed regarding notification and voting procedures.

These voting requirements will ensure that there is broad support for the move to employee ownership. They will also provide a safeguard against a small group of employees buying out their employer, potentially against the wishes and/or interests of their fellow employees.

An "employee-ownership" LSVCC will be required to have immediate control over the fundamental business decisions affecting the operation that is being acquired. Where this control is not obtained through immediate majority ownership, the business plan must outline a reasonable time frame for achieving majority ownership.

The requirement that the employees acquire majority ownership of their employer's business ensures that they are willing to make a significant commitment to the future of the firm. It also contemplates equity participation by other investors to the extent that these investors, which could include a Labour-Sponsored Investment Fund, could assist the employees through a minority interest in the eligible business.

Restrictions on Investments

An "employee-ownership" LSVCC will be required to invest in the eligible business at least 80 per cent of the funds that it raises. These funds must be invested in the eligible business within one year.

As is the case with Labour-Sponsored Investment Funds, any funds not invested in the eligible business must be held in relatively liquid, secure investments.

Capitalization Limits

The amount required to purchase the interest in the eligible business and any immediate capital expenditures required to continue carrying on the business, as approved by the Tripartite Review Board, will determine the total authorized capitalization of the LSVCC. Any subsequent increases to the capitalization limit will also have to be approved by the Board.

Limiting the capitalization of the LSVCC in this manner ensures that the tax credits available to the employees are in respect of the original purchase only. It is not intended that tax credits be provided for investments beyond those contained in the business plan.

Share Valuations

The shares of "employee-ownership" LSVCCs will be valued in accordance with the rules set out for Labour-Sponsored Investment Funds.

Conditions for Maintaining LSVCC Status

"Employee-ownership" LSVCCs will be subject to similar reporting requirements as Labour-Sponsored Investment Funds. As well, an "employee-ownership" LSVCC will be required to adhere to the investment restrictions described above to maintain its status.

In addition, an "employee-ownership" LSVCC will not be permitted to participate in any reorganization involving the LSVCC or the eligible business without incorporating such reorganization in a revised application for approval by the Tripartite Review Board. This requirement will apply so long as any of the LSVCC's shares remain subject to the five-year holding period requirement. If the LSVCC violates these conditions, or fails to comply with the business plan, investment plan or human resources plan, its registration could be revoked. This provision is intended to ensure effective administration and auditing of the program.

If an "employee-ownership" LSVCC has its registration revoked or if it otherwise ceases operation, it will be subject to the same tax credit recapture provisions that apply to Labour-Sponsored Investment Funds.

An LSVCC may temporarily invest in a new corporation formed solely for the purpose of amalgamating with an eligible business, provided that such an amalgamation is described in the initial application and is approved by the Tripartite Review Board.

Eligible Investors

Definition of an Eligible Investor

The only eligible investors in an "employee-ownership" LSVCC are the employees of the eligible business. The employees' shares in the "employee-ownership" LSVCC will have the same full voting and dividend rights as the Class A shares in Labour-Sponsored Investment Funds. Only Ontario residents will receive the tax credits.

The employees could establish a voting trust for their shares in the LSVCC if they so desired.

Definition of an Eligible Employee

Eligible employees include all individuals employed in the eligible business, whether unionized or not. Excluded from the definition of employees are: individuals employed by the firm who control, or are related to someone who controls, more than ten per cent of the voting shares of the company; or individuals related to a partner in the business.

The definition of an employee is intended to limit the tax credit to arm's length employees.

Tax Incentive

Employees investing in an "employee-ownership" LSVCC will be entitled to an Ontario tax credit of 20 per cent on the first \$3,500 and up to 30 per cent on the incremental investment. The maximum annual investment by an employee will be limited to \$15,000. The credit can be applied up to the amount of Ontario tax owing, with a five-year carry forward of unused credits.

The enhanced Ontario tax credit and five-year carry forward of unused credits reflect the need to encourage worker ownership, and recognize the greater financial risk faced by individuals investing in their employer corporation. The costs of acquiring a significant interest in an employer corporation can be large relative to the employee's income. The \$15,000 annual investment limit ensures that in most cases the full investment will be eligible for the tax credit.

Ontario will ask the federal government to provide complementary tax credits for investments in "employee-ownership" LSVCCs.

Limit on Total Investments

The total amount of investments eligible for the provincial tax credit is limited to the first \$150,000 of that employee's investment in the "employee-ownership" LSVCC. When an employee's cumulative investment in the LSVCC exceeds \$150,000, the excess amount will not be eligible for the Ontario tax credit. The total investment limit will be applied separately to each "employee-ownership" LSVCC in which the employee invests.

By capping the tax benefits, the limit promotes a more even distribution of share ownership among a company's employees, rather than skewing the benefits toward higher income workers. This provision is intended to reinforce the equitable share distribution plan that will be required from each LSVCC.

Applying the cumulative limit on a per-LSVCC basis recognizes that in some situations the employee's share purchases may be mandatory as a condition of employment.

Restrictions on Investors

Investments in "employee-ownership" LSVCCs will be subject to the same five-year holding period that applies to Labour-Sponsored Investment Funds.

Also, the rules pertaining to share redemptions will largely parallel those that apply to Labour-Sponsored Investment Funds. Redemptions at any time within the five-year period will be allowed where employment is terminated for reasons of death, long-term illness, permanent disability, retirement or involuntary termination of employment. Where redemptions occur for other reasons, the Ontario tax credit will be recaptured on shares purchased within the previous five years.

In the case of retirement, the shares must be outstanding for at least two years to avoid recapture of the tax credits.

3.5 Other Issues for Consultation

Application of Program to Co-operatives

Co-operative corporations, by design, subscribe to the participatory values which this program promotes. Co-operatives are currently not eligible for this program due to a number of technical issues which remain to be addressed. Many of these issues relate to limitations in the Co-operative Corporations Act (CCA).

Through the consultation process, the Government will be seeking to identify the changes to the CCA and this program necessary to enable co-operatives to participate in the program.

Interaction of Program with Ontario Securities Act

The proposed program will provide tax credits on newly issued shares of Labour-Sponsored Investment Funds and "employee-ownership" LSVCCs.

The Ontario Securities Act regulates the sale and distribution of securities in the province. There are a number of issues that arise under the Act with respect to the proposed program. The most significant of these are the requirements concerning disclosure and the issuance and sale of the shares.

The Government anticipates that the consultation process will assist in identifying workable solutions to these issues.

Role of the Federal Government

As part of the consultation process, a number of issues under federal jurisdiction will be discussed with the federal government. In addition to the question of federal participation, other issues to be discussed will include the treatment of Ontario LSVCC shares for RRSP and capital gains purposes.

CHAPTER 4: FUTURE ROLE OF ONTARIO'S SBDC AND ESOP PROGRAMS

Ontario currently provides two incentive programs which serve the same broad policy objectives as the proposed Ontario Investment and Worker Ownership Program.

- The Small Business Development Corporation (SBDC) program provides equity capital for the development and expansion of small businesses in Ontario.
- The Employee Share Ownership Plan (ESOP) program promotes employee ownership and is intended to foster co-operation and participation in the workplace. The program also provides a new source of equity capital for small and medium-sized businesses.

4.1 Small Business Development Corporations (SBDCs)

An SBDC is a holding company which raises investment capital by selling shares and reinvesting the proceeds in eligible small businesses in Ontario. Investors who buy new equity shares in SBDCs receive from the Ontario Government a tax-free grant of 25 per cent (30 per cent in Northern and Eastern Ontario) of the cost of the shares.

Since its introduction in 1979, the SBDC program has helped finance over 2,400 investments, facilitating the investment of almost \$500 million in Ontario small businesses.

The main features of the SBDC program are as follows:

- An SBDC may be formed by individuals and corporations, including employees of a target investee company. Although employees could use this program to take a minority ownership position in their employer company, the program has not been widely used for this purpose.
- SBDCs must invest in small businesses with 150 employees or less. Investee companies must pay 75 per cent of total wages and salaries in Ontario, and must be primarily engaged in eligible activities including: manufacturing; tourism; research and development; computer software development; cultural industries; services to commercial business; and services in support of mining and forestry.
- SBDCs must invest in new equity and must take minority positions in target investee companies. SBDCs cannot be leveraged and, because of the restrictions placed upon them, cannot be used to facilitate an employee buyout.
- The incentives available under the program range from a minimum grant of \$15,000 to a maximum of \$3 million. An SBDC may not raise more than \$10 million.

- The federal government does not provide financial support or incentives for SBDC investors except when SBDC shares are sold. The grant does not reduce the cost base of the SBDC shares for purposes of calculating taxable capital gains; therefore, the individual's capital gain only includes the incremental value of the share over the initial purchase price.

4.2 Employee Share Ownership Plans (ESOPs)

An ESOP is a registered Employee Share Ownership Plan under which employees of small and medium-sized businesses purchase new equity shares in their employer's firm. Employees who purchase shares under a registered ESOP receive a tax-free grant from the Ontario Government. This grant is equal to 15 per cent of the cost of the shares, to an annual maximum of \$300 per employee.

Since the introduction of the Ontario ESOP in 1988, nine firms have registered under the program. To date, the program has provided grants amounting to \$35,000 on total employee equity of \$235,000.

The main features of the Ontario ESOP program are as follows:

- ESOPs are only available to workers in firms with \$50 million or less in assets or gross revenues, and which pay at least 25 per cent of wages and salaries in Ontario.
- The ESOP program facilitates the direct purchase of shares only. As there is no intermediary legal entity, the program does not provide for leveraged share purchases except at the individual level.
- Individual employees must hold less than ten per cent of the shares, and all shares purchased must be new equity. Except in the case of significant financial restructuring, this precludes the ESOP from being used for employee buyouts.
- The Ontario Government provides a cash grant to cover 50 per cent of set-up costs incurred by employee groups, to a maximum of \$5,000.
- Although the program is intended to promote employee participation and labour-management co-operation, these are not specific eligibility requirements.
- The federal government does not provide financial support or incentives for ESOPs.

4.3 Options

With the introduction of the proposed Ontario Investment and Worker Ownership Program, Ontario will have three separate programs for meeting the policy objectives of facilitating the financing of industrial restructuring and growth, and encouraging worker ownership and participation.

Although the three programs serve essentially the same purpose, they operate differently and appeal to different client groups.

- The Labour-Sponsored Investment Fund component is targeted at Ontario residents interested in participating in Ontario's economic restructuring, as well as at labour groups looking for a vehicle for collective participation in the restructuring process. The SBDC appeals to individuals and corporations with an interest in investing in small Ontario firms.
- The "employee-ownership" LSVCC component facilitates employee buyouts and ensures more active employee participation in the ongoing management of their employer's firm. The ESOP is geared toward employees wishing to make small purchases of new equity issued by their employer.

The roles of the SBDC and ESOP programs need to be examined. Possible options include: maintaining all three programs; or eliminating or modifying the ESOP and/or SBDC programs.

CHAPTER 5: NEXT STEPS

5.1 Consultation Process

The Ontario Government is committed to working in partnership with business, labour and other members of the community to find creative solutions that work best for Ontario. To foster this dialogue, the Government is releasing this discussion paper and draft legislation to solicit the views of interested parties on the proposed Ontario Investment and Worker Ownership Program.

The Government also welcomes interested parties to express their views on the SBDC and ESOP programs. All comments will be taken into account when these programs are reviewed.

The deadline for receipt of written submissions is September 26, 1991.

Written submissions should be addressed to Bob Christie, Assistant Deputy Minister, Taxation and Intergovernmental Finance Policy Division, Ministry of Treasury and Economics, 4th Floor, Frost Building South, Queen's Park, Toronto, Ontario, M7A 1Y7.

Questions concerning the program or the consultation process, and requests for additional copies of the discussion paper and draft legislation, should be directed to Jackie Boyle, Director, Communications Branch, Ministry of Treasury and Economics, 5th Floor, Frost Building South, Queen's Park, Toronto, Ontario, M7A 1Y7 (Telephone number: (416) 965-7171).

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